No. 14796.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

H. S. ANDERSON, JR., *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee.*

ETHEL H. ANDERSON, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee.*

ROBERT W. ANDERSON, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee.*

GLORIA S. ANDERSON, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee.*

JOHN HARDY ANDERSON, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee.*

Appeals From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLANTS.

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Appeals From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLANTS.

Jurisdiction.

Deficiencies in Federal income taxes for the calendar year 1943 having been assessed against and collected from appellants in February and March, 1947 [R. 8 and 29],

each of the appellants on December 28, 1948, filed with the Collector of Internal Revenue at Los Angeles, California, a claim for refund thereof. [R. 8, 30, 15-21.] The claims were disallowed by the Commissioner of Internal Revenue by registered notices dated August 29, 1949. [R. 8-9, 27-8, 30.] The complaints for recovery of the alleged overpayments of income tax and interest, with copies of the claims for refund attached as exhibits, were filed with the United States District Court for the Southern District of California, Central Division, on August 4, 1950. [R. 3-28.] The five causes, involving the identical issue, were consolidated for trial below, and are presented here on appeal on the record in one of the five cases by stipulation. [R. 271.]

On June 30, 1954, the Court below entered its Memorandum of Decision [R. 59-68]; and on March 18, 1955, the District Court filed Findings of Fact and Conclusions of Law [R. 71-92] and entered Judgments dismissing the complaints. [R. 92-100.] The Notices of Appeal were filed by appellants on May 20, 1955. [R. 100-106.]

The claims for refund were filed under and within the two-year period prescribed by Section 322 of the Internal Revenue Code. (26 U. S. C. 322.) The complaints were filed in the District Court within the two-year period prescribed by Section 3772(a)(2) of the Internal Revenue Code (26 U. S. C. 3772(a)(2)), and pursuant to the authority contained in Title 28, Section 1346(a)(1), of the United States Code. The taxes in controversy were paid to Harry C. Westover, the then Collector of Internal Revenue, but who was not in office as Collector of Internal Revenue when these actions were commenced. [R. 4, 28.] The appellants are residents of the County of Los Angeles, California, within the judicial district

in which the complaints were filed, as required by Title 28, Section 1402(a), of the United States Code. [R. 3, 28.] From the adverse final Judgments of the District Court, appellants have appealed to this Honorable Court, the jurisdiction of which rests upon Title 28, Section 1291, of the United States Code.

Summary Statement of the Case.

1. Three of the appellants, plaintiffs below, Harold S. Anderson, Jr., Robert W. Anderson, and John Hardy Anderson, are adult sons of Harold S. Anderson, Sr. Ethel H. Anderson is the wife of Harold S. Anderson, Jr., and Gloria S. Anderson is the wife of Robert W. Anderson, these wives being the other two appellants.

2. Harold S. Anderson, Sr., died intestate on December 27, 1941. Prior to and on the date of his death he was a member of a co-partnership (hereinafter referred to as the California partnership) consisting of himself and his son, H. S. Anderson, Jr., one of the appellants, in which Harold S. Anderson, Sr., the decedent, owned a 75% interest and H. S. Anderson, Jr., owned a 25 per cent interest. The business of the co-partnership consisted of subsistence contracting work (feeding and housing defense workers) and was conducted in the States of California and Nevada under the name of "H. S. Anderson." The California partnership was organized on January 1, 1938, by virtue of an oral agreement between the decedent and H. S. Anderson, Jr., which contained no provision for continuance of the partnership in the event of death of one of the partners. [R. 74-5.]

3. After almost a year of arms-length negotiation between H. S. Anderson, Jr., both in his capacity as administrator of his father's estate and as the surviving

partner of the California partnership, and the widow of the decedent (who was the stepmother of H. S. Anderson, Jr.), H. S. Anderson, Jr. agreed to pay into the decedent's estate the sum of $75,000.00, representing the fair market value at the date of his death of the decedent's interest in the California partnership, together with the sum of $228,369.32, representing the estate's share of the profits of the California partnership from the date of death to the date of the agreement (to wit, December 11, 1942). The actual language of the agreement in this respect was as follows [Ex. 2, R. 117-8, 77-8, 173]:

> "6. H. S. Anderson, Jr., as surviving partner of the California Partnership, in full satisfaction and discharge of all claims of the estate of H. S. Anderson, deceased, and of the heirs of H. S. Anderson, deceased, for and on account of the interest of said H. S. Anderson in his lifetime and that his estate has acquired since his death in and to the California Partnership, hereby agrees to pay into the estate of H. S. Anderson, deceased, the following sums of money:
>
> > "(a) The sum of $75,000.00, representing, as the parties hereto agree, the fair market value at date of the death of the decedent, of his interest in said California partnership;
> >
> > "(b) The sum of $228,369.32, representing, as the parties hereto agree, the estate's share of the profits of the California Partnership from the date of the death of the decedent, December 27, 1941, to the date of this agreement."

4. On the date of the decedent's death the California partnership was obligated to the decedent for advances made by him in the sum of $29,013.36, and these advances were repaid to his estate—in addition to the sum

of $75,000.00 hereinabove referred to, the agreement of December 11, 1942 providing as follows in this respect [R. 121]:

> "11. It is recognized and agreed by all of the parties hereto that at the date of death of decedent, The California Partnership was obligated for advances made by H. S. Anderson, deceased, in the amount of $29,013.36.
>
> "It is further understood and agreed that the said sum of $29,013.36, owed to the decedent at the date of his death by The California Partnership was community property and that the same shall be paid into the estate by the surviving partner, H. S. Anderson, Jr."

5. Said agreement of December 11, 1942, was approved by the Superior Court of the State of California in and for the County of Los Angeles, sitting as a court of probate, on December 22, 1942. [R. 79.]

6. The amounts specified in the agreement were duly paid into the estate of the decedent. Prior to signing the agreement it had been understood by the five appellants that they would join together in the formation of a new limited partnership to carry on the business. This was done. The three brothers borrowed money from a bank in order to make the payment of $75,000.00, the note being signed on December 16, 1942 and secured by a continuing guarantee signed by all five appellants. The sum of $75,000.00 was actually paid into the estate by the five appellants on or about December 21, 1942; and they were credited with their respective shares of the payment on the books of a new limited partnership which was created on December 23, 1942, for the purpose of carrying on the business. [R. 206-211; Exs. 22, 23.] The

interests of the five appellants in the limited partnership were: Harold 42.5 per cent and his wife Ethel 7.5 per cent (or 50 per cent between them); Robert 21.25 per cent and his wife Gloria 3.75 per cent (or 25 per cent between them); and John 25 per cent. [Ex. 3.] The sum of $75,000.00 was deducted by these five individuals in computing their net incomes for the years 1942 and 1943 in these relative proportions, one-half in each year. The deductions were disallowed by the Commissioner of Internal Revenue, as a result of which income tax deficiencies were paid, a portion of which is sought to be recovered in these actions.

7. On the date of decedent's death the California partnership was engaged in subsistence work at Camps San Luis Obispo and Roberts, California Shipbuilding Yards, Douglas Aircraft Plant, and Basic Magnesium, under contracts or purchase orders which had stipulated economic useful lives of two years from and after December 31, 1941. [R. 53-5.] These contracts and purchase orders had no cost and hence did not appear as assets on the books of the partnership.

8. The liability due the decedent in the sum of $29,013.26, as aforesaid, was actually the amount to his credit in his capital account on the books of the partnership at the date of death, and, pursuant to the understanding with the surviving partner, H. S. Anderson, Jr., was treated as a liability of the partnership instead of capital. In other words, since the decedent had contributed both services and capital, whereas the son had contributed

only services, the agreement between them was that the money contributed by the decedent would be treated as a liability and repaid to the decedent. The result was that there was no net worth or net asset value on the partnership books, the liabilities equalling the assets. [Ex. 16, R. 127, 177-8.]

9. The appellants filed their claims for refund alleging that the sum of $75,000.00 was deductible either as an ordinary and necessary expense, or, in the alternative, if the payment should be capitalized, it should be treated as the cost of said contracts and purchase orders having a two-year life at date of death of the decedent, and the amount paid should be amortized over the two-year period, which would be 1942 and 1943. [R. 19.] Taxwise, the result would be the same in either event. The Commissioner disallowed the claims, as heretofore stated.

10. When he died the decedent was a member of another partnership, known as the Alaska partnership, he having a 40 per cent interest therein, Robert 30 per cent, John 20 per cent, and Harold, Jr. 10 per cent. [R. 75.] In the agreement of December 11, 1942, the three sons, as surviving partners, agreed to pay into the estate of the decedent the sum of $50,000.00 in a manner similar to the $75,000.00 payment. The Alaska partnership was engaged in subsistence contract work in connection with the construction of the air base at Anchorage, Alaska, pursuant to a contract with the War Department, the useful economic life of which was two years from and after December 31, 1941. [R. 53, 55.] Inasmuch as

there was a net asset value on the books of the Alaska partnership on the date of death, the decedent's capital account showing an investment of $39,438.70, appellants contend that they are entitled to a deduction on account of the $50,000.00 payment only to the extent that it exceeds the sum of $39,438.70, or only $10,561.30. [Ex. 17, R. 128.]

11. The values of the decedent's interests in the two partnerships on the date of his death were taxed as part of his gross estate. The expectation of profits to be derived from the contracts and purchase orders was realized, for the California business in the years 1942 and 1943 resulted in income of $275,000.00 and $185,000.00, respectively, while the Alaska business resulted in income of $97,000.00 and $131,000.00, respectively.

Specification of Errors.

1. The District Court erred in holding that the sum of $75,000.00 paid by appellants into the decedent's estate could not be capitalized and amortized over the economic useful lives (two years) of the assets of the business purchased by said payment, or, in the alternative, deducted as current expense during said two years.

2. The District Court erred in refusing and failing to find as a fact that said sum of $75,000.00 was paid into decedent's estate because of the existence at the date of his death of certain valuable contracts and purchase orders having two-year lives; and in finding, to the contrary and without support in the record, that said contracts and

purchase orders had no substantial value and that the California partnership had net assets of $71,000.00 other than and in addition to said contracts and purchase orders.

3. The District Court committed the foregoing errors with respect to $10,561.30 of the $50,000.00 paid into decedent's estate in respect of his interest in the Alaska partnership.

Summary of Argument.

Under California law, when a partner dies and the death dissolves the partnership, the decedent's interest in partnership assets vests in the surviving partner. But the latter holds the decedent's interest in such assets as a trustee and must account to the decedent's estate for their worth. When he pays the estate the value of the decedent's interest in such assets he acquires for himself the beneficial ownership of them, and what he pays becomes the cost basis of the assets. To hold that the cost is not the cost of the assets, but is the cost of an intangible interest in a partnership, as did the lower court, is to lose sight of the simple fact that death dissolved the partnership and that the decedent's interest therein, as a separate intangible asset, ceased to exist or will cease to exist the moment the purchase is made. There remain only the underlying assets representing the values purchased, to which the cost must be assigned.

The testimony regarding the value of the contracts and purchase orders was not contradicted.

ARGUMENT.

I.

The District Court Erred in Holding That the Sum of $75,000.00 Paid by Appellants Into the Decedent's Estate Could Not Be Capitalized and Amortized Over the Economic Useful Lives (Two Years) of the Assets of the Business Purchased by Said Payment, or, in the Alternative, Deducted as Current Expense During Said Two Years.

The conclusions of law of the lower court appear on page 91 of the record. Limiting our consideration here for the moment to the California partnership, which is the principal source of controversy, those conclusions of law are in essence that:

(a) by the payment of $75,000.00 to the estate of their father the three Anderson sons and the wives of two of them "* * * purchased the interest of H. S. Anderson, deceased, in the partnership known as H. S. Anderson Co. * * * and not specific assets or specific contracts * * *;" and

(b) the sums thus paid "* * * are not deductible as expenses under any provisions of the Internal Revenue Code, are not amortizable, cannot be capitalized and depreciated and did not give rise to deductible losses in 1943 or 1944 or loss carrybacks from 1944 to 1943." [R. 91.]

In its "Memorandum of Decision" the court further stated that "The Courts cannot characterize the situation as one involving good will. * * * The record shows that good will was not purchased * * *, unless it was the small difference between $75,000 and the $71,000 * * *." [R. 64.]

The lower court thus adopted the view urged by the Government, namely, that the sum of $75,000.00 was paid for the decedent's interest in the former California partnership and could not be apportioned as the cost of the various assets used in the business. The result is that appellants have been denied a recovery of their $75,000.00 cost in computing income taxes. They were prohibited deductions as expenses; they could not capitalize the payment and recover their investment through depreciation or amortization deductions; and consequently to this date they have never recovered their cost taxwise.

It is fundamental that the Internal Revenue Code levies a tax upon *net income,* as distinguished from *gross income.* And, with the possible exception of good will which is not involved here, the theory of the Code is to permit deductions from gross income for sums paid out by taxpayers. Payments are classified either as expenses or as capital expenditures. The Code permits a tax recovery of expenses by their outright deduction from gross income in the year paid or incurred. Section 23 authorizes the deduction of business expenses as well as expenses paid for the production of income in the following language:

> "Sec. 23. Deductions From Gross Income.
>
> In computing net income there shall be allowed as deductions:
>
> (a) Expenses.—
>
> (1) Trade or Business Expenses.—
>
> (A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.
>
> *   *   *   *   *   *   *   *

> (2) Non-Trade or Non-Business Expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

If a payment is a capital expenditure (namely, the purchase price of a capital asset or assets), as distinguished from an ordinary current expense, then the payment is capitalized instead of deducted. In that event the recovery of cost, taxwise, is permitted by means of annual depreciation or amortization deductions spread ratably over the economic life of the asset acquired by the purchase. Section 23(1) of the Code provides that in computing net income there shall be allowed as a deduction "* * * A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) —(1) of property used in the trade or business, or (2) of property held for the production of income."

And in this connection Section 23(n) specifies that the "* * * basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114," which requires the same basis for this purpose as is used for the purpose of determining gain upon the sale of property. With exceptions not here pertinent, Section 113 lays down the general rule that such basis is the *"cost of such property."*

When the lower court adopted conclusions of law holding that the sum of $75,000.00 in question here was not deductible as an expense and could not be capitalized and amortized or depreciated, it is respectfully submitted

the court committed fundamental and reversible error. It simply failed to give effect to the plain provisions of the Internal Revenue Code. The result of that error was to tax these appellants upon gross income in that they have not been permitted to deduct or recover their $75,000.00 cost.

Appellants' position in this case is that the sum of $75,000.00 paid by them must be apportioned among partnership assets and recovered by way of depreciation or amortization. The evidence showed, as will appear hereinafter, that the appellants desired to purchase the decedent's interest in the California partnership because of substantial income or profits expected to be derived by them from operation of the business under certain contracts and purchase orders during the two years following the date of decedent's death. Hence, appellants contend that their cost of $75,000.00 should be recovered over said two-year period (1942 and 1943) and out of the income or profits expected to be realized—and which were in fact realized.

Appellants contend that the present case is governed directly by the reasoning of the decision of the Tax Court of the United States in *Nathan Blum,* 5 T. C. 702. The curious point is that appellants here are relying upon the argument which the Government successfully advanced in that case. In that case one of two partners in a partnership bought out the interest of the other partner and soon thereafter sold at a profit certain of the assets which previously had been owned by the partnership. The Treasury Department contended that he should pay tax upon the profit and that he was entitled to use as the cost basis of such assets a fair allocation of the sum which he had paid the retiring partner. The taxpayer

there attempted to be relieved of such tax by arguing that he had not bought assets as such, but merely had bought an interest in the partnership or in the business.

It seems inescapable that the argument thus advanced by the taxpayer in the *Blum* case is precisely the argument which the Government advances here. But the Tax Court rejected the taxpayer's position and applied the familiar doctrine in tax law that if a business (or any other group of assets) is purchased for a lump sum, the purchase price must be allocated among the various assets purchased and gain or loss must be separately computed upon the sale or other disposition of each of the various assets acquired. A corollary of this principle, of course, is that the cost thus allocated to each of the various assets becomes its cost for all purposes, including the basis for computing allowances for depreciation prior to the sale of the asset, as heretofore shown.

In disposing of the conflicting contentions, the purchaser contending that he had merely purchased an intangible partnership interest, while the Government contended that he had purchased an interest in various assets, the court said at page 709:

> "The result contended for by petitioner, however, does not follow from his premise. His contention ignores the fact, which can not be denied, that as a result of the transaction between him and his brother he became sole owner of all the assets of the business and that some of those assets were disposed of during the period from November 1 to December 31, 1940. Petitioner's argument, in a slightly different guise, is in all material respects the same argument that has many times in the past been refuted; that is to say, that where property is acquired as a whole, gain or loss is not realized until it is all disposed of,

even though it be disposed of in parcels. Such contentions are inconsistent with the theory of the tax laws, which are designed to levy taxes upon gains and profits of business for annual periods. *Heiner v. Mellon,* 304 U. S. 271. It is now well settled that where property is acquired as a whole, for a lump sum, and subsequently disposed of a portion at a time, there must be an allocation of the cost or other basis over the several units (except where apportionment would be wholly impracticable) and gain or loss computed and reported upon the disposition of each part. See *Santa Maria Gas Co.,* 10 B. T. A. 1412; *O. H. Himelick,* 32 B. T. A. 792; *Bancitaly Corporation,* 34 B. T. A. 494; *T. H. Symington & Sons, Inc.,* 35 B. T. A. 711; *cf. Heiner v. Mellon, supra.*

"The cases relied upon by petitioner, among them *Commissioner v. Shapiro,* 125 Fed. (2d) 532; *Thornley v. Commissioner,* 147 Fed. (2d) 416, reversing 2 T. C. 220; *McClellan v. Commissioner,* 117 Fed. (2d) 988, affirming 42 B. T. A. 124; *Dudley T. Humphrey,* 32 B. T. A. 280; and *Williams v. McGowan,* 58 Fed. Supp. 692, we think, are not in point. The issue in most of these cases was the taxability of a retiring partner, and the problem was whether that partner's gain or loss was ordinary or capital. In the *McGowan* case, the issue was whether the loss sustained by a surviving partner who purchased the interest of his deceased partner and some two weeks later sold the entire business was an ordinary loss or a capital loss. Such is not the problem here, for we are not dealing with the sale of the business by petitioner as an entirety. In none of those cases was the proposition contended for by petitioner, namely, that gain or loss is not realized until sale or disposition of the business as such, even hinted at."

It has never been held that amounts paid for a partnership interest are not to be allocated to the partnership assets. The cases of *Commissioner v. Shapiro,* 125 F. 2d 532; *Stilgenbauer v. United States,* 115 F. 2d 283, and *Thornley v. Commissioner,* 147 F. 2d 416, do not so hold. They involved the tax situation of a seller of an interest in a partnership, and whether he realized capital gain or ordinary income. This, in turn, depended upon whether he had sold his partnership interest or his interest in the partnership assets. Those cases did not even consider the tax situation of the purchaser. And, as we have seen from the *Blum* case, if the partnership is dissolved and the purchaser becomes the owner of the assets, it is proper to allocate the payment as the cost of the assets. Indeed, there is nothing else that can be done.

We have set forth in the Appendix hereto the pertinent sections of the California Corporations Code dealing with the rights of partners and their representatives upon the death of a partner. Such provisions may be summarized as follows, insofar as relevant to the instant case:

Unless the partnership agreement contains a provision to the contrary, a partnership is dissolved by the death of a partner. Upon dissolution, the partnership is not terminated, but continues until the winding up of the partnership affairs is completed. Dissolution terminates the authority of the surviving partner to act for the partnership, except to the extent necessary to wind up its affairs.

The three property rights of a partner, as defined by California law, are: (a) his rights in specific partnership property; (b) his interest in the partnership; and (c) his right to participate in the management. With respect to the first right, a partner is a co-owner with his other partners in specific partnership property, holding as a tenant in partnership, and on his death his right in specific partnership property vests in the surviving partner; but such surviving partner has no right to possess the partnership property except for partnership purposes, *i.e.,* winding up purposes. The surviving partner becomes a trustee for the decedent's share, and owes a strict duty to account to his estate for the value of his share of the assets. In *Sibert v. Shaver,* 111 Cal. App. 2d 833, 245 P. 2d 514, 519, the court said:

> "A surviving partner is a trustee of the trust inherited from his decedent, and of the assets of the partnership. As such he owes the maximum of good faith and personal confidence to the decedent and to the latter's beneficiaries. * * *"

When a partner dies, and the surviving partner continues the business, the legal representative of the deceased partner is entitled to be paid the value of the decedent's interest at the date of dissolution of the partnership (*i.e.,* at the date of death), and he is entitled to receive such value with interest, or, at the option of the legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership.

In the present case these statutory provisions were complied with meticulously. The surviving partner accounted to the decedent's estate for the value of the assets, which was agreed to be $75,000.00, and also he paid to the estate, in lieu of interest, the estate's share of the profits of the business for the approximate year following the date of the death, or $228,369.32. Instead of making the purchase of the assets alone, the surviving partner was joined by his two brothers and the spouses of those who were married at the time, and the purchase price was paid by these five in certain designated proportions.

In these actions the appellants seek merely to recover, taxwise, the benefit of their cost of $75,000.00. They earned large amounts of income in 1942 and 1943 as a result of their purchase, upon which they have paid very substantial income taxes. They have not been permitted to deduct the cost to which they were put in order to be able to realize that income.

We respectfully submit that the lower court erred in refusing to permit the appellants to deduct the cost by way of amortization deductions over the two years during which the profits were realized.

II.

The District Court Erred in Refusing and Failing to Find as a Fact That Said Sum of $75,000.00 Was Paid Into Decedent's Estate Because of the Existence at the Date of His Death of Certain Valuable Contracts and Purchase Orders Having Two-year Lives; and in Finding, to the Contrary and Without Support in the Record, That Said Contracts and Purchase Orders Had No Substantial Value and That the California Partnership Had Net Assets of $71,000.00 Other Than and in Addition to Said Contracts and Purchase Orders.

Having erroneously concluded as a matter of law that the purchase price of $75,000.00 could not be apportioned and allocated as the cost basis of the assets of the business, the lower court proceeded to make certain findings of fact diametrically opposed to the evidence, as follows:

(a) Paragraph XVI [R. 84]:

"XVI.

Whatever contracts were in existence at the time of death of the deceased had no substantial value and had as a value only a small percentage of the value of $100,000.00 contended for by plaintiffs. The contracts were never set up on the books of the partnerships as capital assets and never carried any value on the books"

(b) Paragraph XVII [R. 85]:

"XVII.

At the time of decedent's death, the balance sheet of the California partnership as properly adjusted indicates that the decedent had an interest in the California partnership in excess of $71,000.00, without the alleged contracts being listed as assets."

(c) Paragraph XXIV [R. 88]:

"XXIV.

Interests in the respective partnerships were purchased and not specific assets. The sons and their wives could have purchased the specific contracts if they desired but did not do so. Had they done so, and paid into the estate $100,000.00 which they contend is the value of the contracts they could not have purchased thereafter, the interest of the decedent in the California partnership for $75,000.00 and interest in the Alaska partnership for $40,000.00 as the partnerships had other assets and had the value that the plaintiffs now contend been placed upon them, they would have had to pay closer to $150,000.00 for the interest of the decedent in the California partnership alone."

(d) Portions of Paragraph XXVII [R. 89-90]:

"XXVII.

The plaintiff has failed to establish that the California partnership had an asset of substantial value at the date of H. S. Anderson, Senior's death in what later consisted of a subsistence business at the Basic Magnesium plant at Roysen, Nevada. * * * The contracts have no value, were not purchased and could not be deducted as expenses paid for the production or collection of income, or the management, conservation or maintenance of property held for the production of income, or could not be capitalized and amortized or depreciated or allowed as a loss in either 1943 or 1944."

These findings are absolutely devoid of evidence to support them and in fact are contrary to the uncontradicted record. Furthermore, they exhibit the confusion necessarily resulting from the erroneous conclusion of law that "an interest" was purchased rather than specific assets.

The uncontradicted evidence establishes the following facts:

(a) At the date of death of the decedent the liabilities of the California partnership were equal to the assets of the partnership, with the result that there was no net equity or net worth on the books for the decedent's 75 per cent interest in the partnership. [See the balance sheet at December 31, 1941, Ex. 16, R. 127.]

(b) The surviving partner, H. S. Anderson, Jr., testified that he had kept the books of the partnership from 1938 to 1941 [R. 174] and was familiar with the fact that there was no book value or net worth at the time his father died. He was asked why, then, he was willing to agree, in arms-length negotiations with his stepmother through their respective counsel, to pay $75,000.00 to his father's estate. His testimony on this crucial point was as follows (and it was never questioned or contradicted during the entire trial):

> "Q. Was that contract the result of protracted negotiations? A. Yes, some eight months of negotiations.
>
> Q. In that contract you agreed to pay to the estate of your father $75,000 with respect to this California partnership; was that price, value, subject to negotiation between you, on the one hand, and Mrs. Orien Anderson, on the other, through your respective counsel? A. Yes, it was. That was the sixty-four-dollar question, the price that we could agree on as to setting a value on contracts that we were purchasing.
>
> Q. Would you tell the court why you— A. That we hoped to purchase.
>
> Q. Would you tell the court why you were willing to pay into the estate $75,000? A. Well, I

figured that we had a chance to make a profit by operating the contracts, and in our best judgment that was the price that we could afford to pay and get our money back and hope to make, naturally, an additional profit on top of it.

Q. Were you familiar with the books of the company at that time? A. Yes, I was. [56]

Q. And its balance sheet? A. Yes, I was.

Q. What was your educational background? A. I was a graduate from Stanford University in 1936, economics major, and I then went on to Harvard Business School, took a year of business administration courses at Harvard Business School.

* * * * * * * *

Q. Were you aware of the fact—I call your attention there to Exhibit 16—that your father's capital account showed no net worth on the date of his death? [57] A. Yes, I was.

Q. In your negotiations, was anything ever said regarding good will? A. Never anything to my recollection was ever said about good will.

Q. Did you pay any money for good will? A. No.

Q. What was it that you paid for for that $75,000, or obligated yourself?

Mr. McHale: I object to that question, your Honor. The contract speaks for itself and is the best evidence of what the parties purchased. That is Exhibit 2.

The Court: Objection sustained. Let me see Exhibit 16.

(Document handed to the court.)

Q. (By Mr. Bennion): Mr. Anderson, I will ask you if there was any good will in the business of the California partnership at the date of death? A. I would say no.

Q. Would you explain why? A. Well, this business that we happened to be in to me is a business of personal service, and its success depends entirely on the active operating working partners. When H. S. Anderson, Sr., died, the good will was attached to him, any good will that he had built up was certainly his, and as far as I am concerned it died with him. [58]

Q. Why, then, were you willing to pay $75,000? A. Because I was aware from my own knowledge and experience, as a partner in this business, of the profit prospects or possibilities from the contracts that were then existent in this California partnership.

Q. Were those profits realized? A. I would say they definitely were realized.

Q. Do you remember roughly how much profit was earned during '42 and '43 by the California partnership? A. As I recall it, in 1942 the partnership profit was approximately $246,000 as reflected in our books and tax returns.

The Court: How much?

The Witness: $246,000, approximately.

The Court: This is the California partnership?

The Witness: The California partnership, 1942 profit. In 1943, as I recall the California partnership profit was approximately $96,000. And based on that profit showing I think quite naturally the contracts that we bought for $75,000 were certainly well repaid." [R. 173-6.]

And, indeed, at the conclusion of the trial, towards the close of argument, the court made the following observation [R. 261]:

"Now, whether or not plaintiffs' contention is correct that they can take the amount of money that was

> paid and then allocate it is another question. Certainly it would be fair to make a finding that the Anderson Brothers would not have paid the $125,000 ($75,000.00 for the California partnership interest and $50,000.00 for the Alaska partnership interest) if it had not been for the subsistence deals then existing at San Luis Obispo, Camp Roberts—and what is the other one?
>
> Mr. H. S. Anderson: Basic Magnesium, Douglas, and Calship."

Yet we now have the court adopting findings of fact to the effect that the contracts had no substantial value. We respectfully submit the court committed reversible error.

The Court's statements that there were other assets of $71,000.00 and that if the contracts and purchase orders had been purchased as specific assets for $75,000.00 the appellants would have been required to pay some $150,000.00 into the estate, are erroneous and are based upon a misunderstanding of an exhibit introduced by the Government.

As we have shown above, the books of the partnership at date of death showed no net assets; all the assets were offset by liabilities. The Government introduced as Exhibit A a reconstructed balance sheet for the California partnership at December 31, 1941 (a photostatic copy of which appears at page 129 of the record), which was prepared by an Internal Revenue Agent. The parties stipulated that the Agent prepared the revised balance sheet *at a date subsequent to the agreement of December*

11, 1942, the date on which the value of $75,000.00 was agreed upon. In other words, the sum of $75,000.00 was agreed upon as the value of the potential profits in the contracts and purchase orders without any thought of what adjustments might later be made by an Internal Revenue Agent.

Now, an Internal Revenue Agent came in and made a report on December 30, 1942 [Ex. 18], covering the income of the California partnership for the years 1939, 1940 and 1941. Insofar as here material, the Agent adjusted depreciation and restored to the equipment account certain small items of equipment which had been charged to expense on the books. The net result of these adjustments was to increase the equipment account from $24,088.30 per books to $127,316.86 and the depreciation reserve from $21,665.94 to $77,536.87, an increase in the net equipment account of $47,357.63.

By virtue of this and other minor adjustments, the Agent would make it appear that the decedent's capital account on the date of death was $71,601.81 instead of $29,013.26. [Ex. A.]

This is completely fallacious.

In the first place, it happened nearly a month after the figures were agreed upon in the basic contract of December 11, 1942 [Ex. 2] and hence obviously did not influence the agreed and negotiated fair market values. If the balance sheet had shown any amount other than $29,013.26 on the date of death, the figure would have been paid to his estate as repayment of advances made, as indeed the

$29,013.26 was paid. It would have nothing to do with the $75,000.00 paid for the estate's interest in the contracts.

In the second place, by increasing the equipment account by $47,357.63, the Agent did not give the five plaintiffs access to a deduction they otherwise did not enjoy. In the basic agreement of December 11, 1942 [Ex. 2, R. 124-5] the Anderson brothers agreed to pay any income tax deficiencies assessed for years prior to 1942. Hence, when the Agent restored to equipment account items deducted on the 1939, 1940 and 1941 returns, he proposed deficiencies in income tax for those years which the Andersons had to discharge. By paying such deficiencies, they were entitled to depreciation deductions in the subsequent two years. In other words, this was merely trading deductions as between one year and another. It had nothing to do with the $75,000.00 paid for the contracts; and in deducting or amortizing the latter sum the parties are not obtaining the benefit of any double deductions of the same items.

In the third place, the alleged capital of decedent of $71,601.81 includes the sum of $29,013.26 appearing on the partnership books as a liability due him and which was paid to his estate in addition to the value of $75,000.00. [See R. 121, 127, 129.]

In the fourth place, only 75 per cent of the increase in equipment account was attributable to the decedent's interest, or $35,518.22, and one-half of that sum was exhausted by depreciation during the year 1942 while the

estate was still entitled to net income and prior to the acquisition by the appellants. And of the remaining half, or $17,759.11, more than this sum was paid by the plaintiffs as deficiencies in income tax for prior years. Hence, even if the Government's position here were sound in principle (which it is not), in actual experience there would be no dilution of the deductions to which appellants are entitled.

III.

The District Court Committed the Foregoing Errors With Respect to $10,561.30 of the $50,000.00 Paid Into Decedent's Estate in Respect of His Interest in the Alaska Partnership.

What has been said heretofore with respect to the California partnership applies with equal force to the Alaska partnership and for the same reasons. The only difference is this: when decedent died he had a net equity in the assets of the Alaska partnership on its books in the amount of $39,438.70. This amount was not paid to his estate in addition to the $50,000.00, as was the $29,013.36 item in connection with the California partnership. The result is that to the extent there was this net book equity, appellants will recover their investment taxwise through depreciation or amortization of those book assets, or by deducting their costs upon sales. Hence, they are entitled to deduct or recover their $50,000.00 investment in the Alaska partnership only to the extent that such recovery will not be obtained through depreciation of the book assets, and that amount is the difference between the book equity of $39,438.70 and the $50,000.00 paid, or $10,561.30. This latter amount has never been recovered for tax purposes by the appellants.

Conclusion.

In view of the foregoing it is respectfully submitted that the judgments of the lower court should be reversed and the appellants should be held to be entitled to deductions of $75,000.00 and $10,561.30, one-half in each of the years 1942 and 1943.

Dated at Los Angeles, California, this 29th day of November, 1955.

Mackay, McGregor, Reynolds & Bennion,
By A. Calder Mackay,
By Adam Y. Bennion,
By Stafford R. Grady,
Counsel for Appellants.

APPENDIX.

California Corporations Code

1. "§15031. Causes of dissolution. Dissolution is caused: * * *
   (4) By the death of any partner;
   * * *"

2. "§15030. Partnership not terminated by dissolution. On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed."

3. "§15033. General effect of dissolution on authority of partner. Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authoritiy of any partner to act for the partnership, * * *".

4. "§15024. Extent of property rights of a partner. The property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management."

5. "§15025. Nature of a partner's right in specific partnership property. (1) A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

   * * *

   (d) On the death of a partner his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to

possess the partnership property for any but a partnership purpose."

6. "§15026. Nature of partner's interest in the partnership. A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property."

7. "§15042. Rights of retiring partner or estate of deceased partner when the business is continued. When any partner retires or dies, and the business is continued under any of the conditions set forth in Section 15041 (1, 2, 3, 5, 6), or Section 15038 (2b) without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such persons or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; provided, that the creditors of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this section, as provided by Section 15041 (8) of this act."

8. "§15043. Accrual of actions. The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners or the surviving partners or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to to the contrary."